INSURANCE MEDIATION AFTER THE FINANCIAL CRISIS: THE EUROPEAN COMMISSION'S PROPOSALS FOR REVISING THE INSURANCE MEDIATION DIRECTIVE

Jonathan Foster[1]

Introduction

This article offers a personal perspective on the proposals for the amendment of the Insurance Mediation Directive[2] ("IMD 1") which have been put forward by the European Commission. It is based on the Strasbourg text of 3.7.2012 setting out the Commission's proposal,[3] the most recent publicly-available text at the time of the author's BILA lecture in November 2012.

The proposal is proceeding through the European parliamentary process. That means it will be considered by the Council, first at working group stage, and considered by the Parliament. A vote was earlier scheduled for 26th March 2013, a plenary sitting 21st May 2013. The timings have however changed, and the forecast as at the beginning of July 2013 is for a vote in Committee on 24 September 2013, with a plenary sitting date forecast for 22 October 2013, a first and single reading in each case.[4]

It is well recognised that the texts produced by the Commission in texts for directives and regulations may undergo substantial change in the course of progress through the Council and the Parliament.

Before turning to the legal text, it is first useful to consider some major factors bearing on the proposed revisions, and some of the actors that influence this.

Drivers for review

First is the Commission's view following the Commission's implementation check prior to 2008 on Member-States' implementation of the IMD.

The second driver is the 2008 financial crisis itself. In 2010 the G20 asked the OECD, the Financial Stability Board (FSB) and others to develop common principles in financial services to strengthen consumer protection. These principles stipulate that

(a) consumers should always benefit from comparable standards of consumer protection;
(b) all financial service providers and agents that deal directly with consumers should be subject to proper regulation and supervision.

During the European Parliamentary debate on Solvency II, a specific request was made to review the IMD. On 27 January 2010 the Commission addressed a request for advice to CEIOPS. The advice was delivered on 10th November 2010. On 26 October 2010 The Commission launched a public consultation on the Review of the Insurance Mediation Directive.

The Commission's public hearing

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[1] The author is a barrister, a legal adviser at the Financial Conduct Authority (formerly the Financial Services Authority), was seconded to the European Commission for a short period in connection with the development of the Commission's proposal, and is currently working as a legal adviser on secondment at ESMA (the European Securities and Markets Authority). This article does not represent the views of any of these bodies: the views expressed are those of the author alone, and they do not constitute legal advice.

[2] Directive 2002/92/EC.

[3] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0360:FIN:EN:PDF

[4] For an up-to-date position, see http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=SWD(2012)0191

The Commission held a public hearing on 10th December 2010. It is worth looking at the speech of Sharon Bowles MEP, the Chair of ECON, the Economic and Monetary Affairs Committee, at that hearing.[5] She noted a desire

(a) to facilitate cross border activity;
(b) to address complaints about undesirable obstacles such as gold plating practices and the use of general good provisions at national level;
(c) to improve legal certainty in some areas;
(d) to establish a level playing field between intermediaries and direct sales by insurers; and
(e) to ensure better information for consumers.

She went on to comment

> "the IMD seems to be one of the least wanted directives that I have come across. The reasons for this are several: insurance is quite different in the various member States. Perhaps an extreme example is looking at the numbers of compulsory insurances, which ranges from 4 in the UK to 400 in Spain. . . . This immediately makes it clear that there is opportunity for confusion for consumers and businesses who move around the EU.
> "It is easy to understand concern at changes and costs that might be incurred for full harmonisation. So I would say even if full harmonisation were justified — which it is not — now is not the time to put such burdens on the economy or the people, for it is policy holders who ultimately bear the cost. But there are some things, and especially minimum standards, that should be looked at."

She made a digression from the IMD which I don't think we should ignore. She mentioned as one of her principal preoccupations

> "Fund management margins such as multiple layers of undisclosed fees and its impact on pension returns. This problem - notable in the UK, but also elsewhere, sees asset management costs eating up substantially more of a fund's growth than is received by the investor – put another way, measured as a loss to the investor the collective management fees represents a larger fall in value than the worst ever crash on the stock market."

That is perhaps an instructive comment insofar as it touches upon remuneration practices.

She concluded with an interesting remark - directed at Solvency II, but relevant here as showing the level of active engagement of the ECON committee in the Parliament:

> "You may know that in ECON I have stood firm to insist on sufficient time for ECON to consider delegated Acts. I have no intention of yielding on this . . . if it is a choice of a bad rushed job or declining the delegated acts I choose the latter, and I doubt anyone will want that."

Commissioner Michel Barnier also delivered a speech on that day. It is only available on the web in French. Summarising the aim of the IMD revision as "putting citizens and consumers at the heart of the single market", he expands that, to better protection for consumers, better integration of the single market in insurance. He noted that insurance intermediaries play a crucial role in these two respects.

The evaluation of the transposition of IMD 1 had, he said, identified several problems:

- product information for customers was inadequate;
- intermediaries could face conflicts of interest, for example if their remuneration was better for the sale of some items than others;[6]
- There is legal uncertainty over the scope of the directive (regarding differing national interpretations of exemptions from scope) ; and, finally,

[5] See the Commission's insurance mediation information page at http://ec.europa.eu/internal_market/insurance/consumer/mediation/index_en.htm

[6] Of interest is an advertising campaign by Crédit Agricole which appeared on French television in late 2012 and which makes a virtue of their advisers not being remunerated on this basis.

- shortcomings in the process for passporting notifications between competent authorities.

To ensure a coherent response to common challenges, DG Markt would co-ordinate the revision of IMD 1 with MiFID and the PRIPS initiative.

- Transparency, Commissioner Barnier said, should become the rule across the piece, and the IMD revision should bring greater transparency in the distribution of products to ensure better management of any conflicts of interest.
- Finally, there should be a level playing field, so the scope of IMD 2 should include distribution directly by insurers.
  "We think that every purchaser of an insurance product should have the same levels of information and protection, irrespective of from where it is purchased."

For the UK, there is a certain irony in this view, originally implemented following the IMD implementation proposal by HM Treasury in its October 2002 consultation paper.[7] The approach was criticised in the Davidson Review[8] as "gold-plating" and subsequently reversed.

Remuneration (and transparency, and conflicts of interest)

Since the financial crisis in 2008 increasing attention has focused on remuneration practices in a number of directives. For example the first recital in CRD 3 (24 November 2010) states

> "Excessive and imprudent risk-taking in the banking sector has led to the failure of individual financial institutions and systemic problems in Member States and globally, . . . there is agreement by supervisors and regulatory bodies . . . that the inappropriate remuneration structures of some financial institutions have been a contributory factor. Remuneration policies which give incentives to take risks that exceed the general level of risk tolerated by the institution can undermine sound and effective risk management and exacerbate excessive risk-taking behaviour."

Accordingly specific provisions regarding remuneration have been included in a number of directives

- CRD 3 (2010/76/EU), amending the BCD (2006/48/EC)
- AIFMD (2011/61/EU)

and are appearing the drafts of others

- Solvency II level 2 draft
- MiFID 2 draft
- Draft Directive on Credit Agreements relating to Residential Property (the "Mortgage directive")
- CRD 4 draft (2011/0203).

If the aim is to prevent firms from operating remuneration practices that may act against retail clients' best interests, is it necessary to consider directives whose purpose is to ensure prudential soundness? These provisions focus on remuneration policies which promote sound and effective risk management: the FSA (now FCA)'s remuneration code[9] was implemented to meet the remuneration provisions of the Capital Requirements Directive.

In the Remuneration Code, Remuneration Principle 3 states that

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[7] See paragraph 4.2: "The Government considers that to regulate the activities of intermediaries but not insurers would cause confusion to customers, and create an unlevelled playing field in terms of competition between intermediaries and insurers' direct sales forces."

[8] ISBN-13: 978-0-11-840484-6 "the Directive has been gold-plated by extending the scope of the rules on sales of insurance so that they apply to sales by direct insurers as well as sales by insurance intermediaries. HM Treasury decided to extend the scope in this way early on in the implementation process for reasons of consumer protection and fair competition"

[9] See http://fshandbook.info/FS/html/FCA/SYSC/19A

> "A firm must ensure that its remuneration policy includes measures to avoid conflicts of interest".

CEBS guidelines[10] make it clear that measures to avoid conflicts of interest must be applied on "an institution-wide basis". The Solvency 2 level 2 draft and the CRD 4 draft also refer to measures aimed at avoiding conflicts of interest.

Sales staff are not expressly identified as risk takers as envisaged in these provisions, nor is consumer protection against the risk of mis-sales the focus of these directives. However systemic mis-selling could undermine a firm's prudential soundness by exposing the firm to significant claims. Sales staff could be persons "whose professional activities have a material impact on the firm's risk profile". The CEBS guidelines identify staff members or a group whose activities could potentially have a significant impact on the institution's results and/or balance sheet, and include staff with the highest proportion of variable to fixed remuneration and staff earning above a certain absolute threshold of total remuneration. These have the potential to include sales staff.

These "prudential" provisions are governance requirements which though directed at, are not expressly limited to, prudential matters. ESMA has explicitly addressed remuneration in connection with conduct of business in its consultation on guidelines on remuneration policies and practices for MiFID.[11]

The Commission proposal

On 3 July 2012 the Commission adopted a proposal for a revision of the Insurance Mediation Directive ("IMD 2"). The goal of the Commission's proposal is to upgrade consumer protection in the insurance sector by creating common standards across insurance sales and ensuring proper advice.

It will be remembered that in Union legislation, the primary legislation consists of the Treaties: post-Lisbon, that is the TEU and the TFEU. Directives and regulations made by the Union legislature are secondary legislation: they look to the Treaties for their legislative origins. In this framework a directive is a legislative act which directs member states as to the result to be achieved, but leaves the method of achieving that result to national legislation. Thus directives are implemented (or "transposed") in domestic law. A regulation on the other hand regulates member states directly, having direct application in domestic law.[12]

As secondary legislation, directives must be understood and interpreted in the context of the primary legislation, that is, the Treaty powers under which they are made.

At the end of the 1990s, two Interinstitutional agreements were made between the European Parliament, the Council, and the Commission to address the way in which legislation should be drafted and amended.[13] The first of these concentrated on the need for legislative text to be clear and precise and foreseeable in its application to achieve legal certainty.[14] The second addressed the technique known as the recast.[15] The recast is the legislative basis for this proposal.

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[10] 10 December 2010: see http://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf

[11] See ESMA press release on the issue of these guidelines. http://www.esma.europa.eu/system/files/2013-726_press_release_on_mifid_remuneration_guidelines.pdf. The guidelines themselves are at http://www.esma.europa.eu/content/Guidelines-remuneration-policies-MiFID

[12] Article 288 of the TFEU provides that a regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.

[13] The Interinstitutional Agreement of the European Parliament, the Council and the Commission of 22 December 1998 on common guidelines for the quality of drafting of Community legislation, OJ C 73, 17.3.1999, p.1.

[14] Ibid, Recital 2: "according to the case-law of the Court of Justice, the principle of legal certainty, which is part of the Community legal order, requires that Community legislation must be clear and precise and its application foreseeable by individuals. That requirement must be observed all the more strictly in the case of an act liable to have financial consequences and imposing obligations on individuals in order that those concerned may know precisely the extent of the obligations which it imposes on them."

The recasting technique permits the adoption of a single legislative text which simultaneously makes the desired amendment, codifies that amendment with the unchanged provisions of the earlier act, and repeals that act.[16] It is a means of ensuring the readability of Community legislation on a permanent and universal basis.[17] The new act passes through the full legislative process and repeals all the
acts being recast.

The explanatory memorandum accompanying the proposal has to state the reasons for each proposed substantive amendment; and to specify which provisions of the earlier act remain unchanged.[18] The legislative text must be presented in a way that enables the substantive amendments and new recitals to be clearly distinguished from the provisions and recitals which remain unchanged.

Member-States' implementation obligations under the repealed directive are not affected by the repeal; and the obligation in the recast directive to transpose into national law relates only to the provisions which have undergone substantial amendment.

According to the case-law of the Court of Justice, the principle of legal certainty, which is part of the Community legal order, requires that Community legislation must be clear and precise and its application foreseeable by individuals. That requirement must be observed all the more strictly in the case of an act liable to have consequences and imposing obligations on individuals in order that those concerned may know precisely the extent of the obligations which it imposes on them.

Lamfalussy and Lisbonisation

To avoid making legislation over-complicated and technical, the Lisbon Treaty introduced a new system to delegate some limited powers to the European Commission. This is the procedure under Article 290 and 291.

The perennial need for the EU's legislators (Parliament and the Council) to delegate some legislative power, as happens in many national law-making systems, was previously met through the "comitology" procedure.

The Treaty of Lisbon provides that the relationship between the Commission and its committees is henceforth organised on the basis of a regulation adopted by the European Parliament under the ordinary legislative procedure.

Under the provisions of Articles 290 and 291 TFEU, the Commission adopted proposals for Regulations establishing EBA, EIOPA, and ESMA, the European Supervisory Authorities, the ESAs, on 23 September 2009. In this respect, the Commission refers to the Statements in relation to Articles 290 and 291 TFEU which it made at the adoption of the Regulations establishing the European Supervisory Authorities, according to which:

> "As regards the process for the adoption of regulatory standards, the Commission emphasises the unique character of the financial services sector, following from the Lamfalussy structure and explicitly recognised in Declaration 39 to the TFEU. However, the Commission has serious doubts whether the restrictions on its role when adopting delegated acts and implementing measures are in line with Articles 290 and 291 TFEU."

The Content

In the proposal, the legal text is preceded by the Explanatory Memorandum, which sets out the Commission's reasons for the proposals in the form they are put forward. Usefully it sets out the legal basis and provides a summary of the provisions. The proposal is accompanied by an impact assessment, which provides a cost-benefit analysis of the proposal, together with a number of supporting Annexes. As to the legal text itself, the following paragraphs offer a commentary on major changes to the text.

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[15] The Interinstitutional Agreement between the Parliament the Council and the Commission of 28th November 2001, OJ C 77, 28.3.2002, p.1.
[16] Ibid, see recital 5, which lays down procedural rules for recasts.
[17] Ibid, recital 6.
[18] Ibid, Article 6.

Chapter I — Scope and Definitions

Article 1 enlarges the scope of IMD 1 to include sales of insurance contracts by insurance and reinsurance undertakings without the intervention of an insurance intermediary . It also covers claims management activities by and for insurance undertakings, loss adjusting and expert appraisal of claims. The 'de minimis' €500 exclusion from the scope in IMD 1 remains, is increased to €600, and clearly operates on pro rata basis (less than €2 per day). So, opticians selling complementary insurances on glasses still remain out of scope of the Directive.

The insurance policies sold ancillary to the sale of services such as travel insurance policies sold by travel agents, general insurance policies sold by car rental companies and leasing companies fall within the scope of the proposal.

Article 2 changes some definitions and adds new definitions.

- 'Insurance mediation' is extended to include the extension of scope in Article l and specifies that certain activities by insurance aggregator websites constitute insurance mediation.
- The activity of 'introducing' is removed.
- 'Reinsurance mediation' is amended likewise.
- 'Insurance investment products' are defined to follow the definition of 'investment product' in the Regulation on key information documents for investment products (Regulation on PRIPs).
- 'Tied insurance intermediary' is extended to include intermediaries working under the responsibility of another insurance intermediary.
- 'Advice' is defined as the provision of a personal recommendation to a customer, on request or otherwise.
- 'Cross-selling practice' defines a practice where two or more products are bundled together in a single sale.
- 'Contingent commission' is defined as a commission where the amount payable is based achievement of agreed targets.
- 'Remuneration' is defined to include not only payments (fees, commission, etc.) but also economic benefits of any kind.

'Professional customer' is also defined for the purposes of disapplying the information provisions of Articles 16 to 18. The definition is by way of Article 19 and the Annex.

Chapter II – Registration requirements

Article 3 lays down the registration procedure. New is the provision under which an insurance undertaking or intermediary may assume responsibility for ensuring an intermediary acting under its responsibility meets the registration requirements of the proposal.

Chapter III – Declaration procedure

Article 4 establishes a simplified procedure which exempts two groups of persons from the registration procedure of Article 3, enabling them to carry on mediation activities by way of a simple declaration. They are

- those who conduct insurance mediation as an activity ancillary to their principal professional activity, and who meet certain other conditions, such as travel agents. (Broadly, the other conditions are that the products are complementary to another product or service, do not cover life assurance or liability risks other than incidental cover); and
- those whose activities are limited to the professional management of claims and to loss adjustment.

The declaration procedure mainly covers travel agents, car rentals selling insurance products as well as loss adjusters and claim handlers.[19]

[19] See page 70 of the Annexes to the Commission's Impact Assessment for a chart which illustrates the scope provisions: http://ec.europa.eu/internal_market/insurance/docs/consumers/mediation/20120703-impact-assessment_annex_en.pdf.

Chapter IV – Freedom to provide services and freedom of establishment

Articles 5, 6, and 7 reflect the provisions in Article 5 of IMD l, the revised MiFID proposal and the Luxembourg Protocol. They also address the division of competence between Home and Host Member State supervisors, particularly in situations where an insurance or reinsurance intermediary is not meeting its obligations when transacting business in the Host Member State.

Chapter V – Other organisational measures

Article 8 sets out the professional and organisational requirements that comprise Article 4 in IMD 1. It adds a requirement for continuous professional development. The Commission is empowered to adopt delegated acts to specify the notion of adequate knowledge and ability.

Article 9 concerns the publication of general good rules. This article has changed from Article 6 in IMD l and now requires Member States to publish the general good rules[20] and requires EIOPA to publish information about such rules.

Article 14 concerns the restriction on the use of intermediaries. It extends the former Article 3(6) of IMD 1 to reinsurance undertakings and insurance and reinsurance intermediaries, and takes into account the declaration procedure (see Article 4).

Chapter VI – Information requirements and conduct of business rules

Articles 15 to 20 restate the disclosure requirements, the large risks exemption, the stricter provisions in ex-Article 12, and the information conditions of ex-Article 13. They also set out the following additional provisions and disclosures:

- a general principle for intermediaries and insurance undertakings when carrying out insurance intermediation to act honestly, fairly and professionally in accordance with the best interests of their customers;
- whether the intermediary is representing the customer or is acting for and on behalf of the insurance undertaking;
- whether the intermediary or the insurance undertaking provides advice;
- the basis and amount of the remuneration by insurance intermediaries;
- the amount of any variable remuneration received by the sales employees of insurance undertakings and intermediaries;
- a mandatory ‘full disclosure‘ regime for the sale life insurance products and an 'on-request‘ regime (i.e. on customer's demand) for the sale of non-life products with a transitional period of 5 years. After the expiry of the 5 years transitional period, the full disclosure regime will automatically apply for the sale of non-life products as well.

Broadly, the information provisions in Articles 16, 17 and 18 do not apply in the mediation of large risks, or in relation to professional customers as specified in Article 19 and the Annex.

The Explanatory memorandum describes these provisions in the following terms:[21]

> “In terms of achieving higher consumer protection, these provisions offer higher transparency compared with IMD 1 regarding the nature, the structure and the amount of the intermediary's remuneration, and they provide clarity with regard to the principal-agent relationship, including how this may impact on advice. Consumer protection has moved forward significantly over the last years, and consumers are today increasingly information-seeking and cost-conscious. The Commission’s view is that disclosure of the different elements of the total price – including the intermediary's remuneration – will enable the customer to choose on the basis of insurance cover, linked services (for example if the intermediary carries on claims-handling) and price. This will further ensure suitable, cost-efficient products and

[20] For an indicative exposition of the principles of general good in relation to the Third Insurance Directives, see the Commission's Interpretative Communication on freedom to provide services and the general good in the insurance sector 2000/C43/03.

[21] See Explanatory memorandum, page 10.

> intermediary services for consumers. Mandatory disclosure of remuneration should have positive effects on competition in insurance distribution as it would ensure that consumers receive wider information on products and costs, as well as possible conflicts of interest. It will be easier for consumers to compare insurance covers and prices between products sold through different distribution channels."

It continues

> "The remuneration disclosure must however be implemented in a way that the comparison between intermediaries and direct writers is ensured. Information about the price of cover as well as the distribution costs will provide comparability. In particular, for avoiding situations of conflict of interest, insurance undertakings should also disclose the basis for the calculation of their employees' variable remuneration resulting from the sale of a product.
> These provisions furthermore address certain key problems related to cross-border provision of insurance intermediary services: lack of legal certainty and lack of comparability. If the harmonised legal framework is improved, intermediaries as well as their customers may more readily take the step of selling or buying insurance products cross-border. Improved disclosure will facilitate comparison between products and distribution channels (as mentioned above), which is today particularly difficult in cross-border trade situations."

Article 21 introduces a provision on bundling products together and requires that the customer be informed that the products may be purchased separately and be given certain information in this regard. It also requires EIOPA to develop, and thereafter update guidelines for the supervision of such practices. [22]

[22] See Explanatory memorandum, page 10.

Chapter VII – Additional customer protection requirements in relation to insurance investment products

Article 22 covers the scope of these additional provisions, applying them to an insurance intermediary or undertaking when they sell insurance investment products.

Article 23 contains additional conflicts of interest provisions, requiring such conflicts to be identified. It gives the Commission power by delegated act[23] to

- define steps to identify, prevent, manage and disclose such conflicts; and
- establish criteria for specifying types of conflicts which may damage the interests of customers.

Article 24 is based on Article [23] of MiFID II. It sets out the MiFID II requirement to

- act honestly fairly and professionally in accordance with the best interests of customers;
- ensure that information is fair clear and not misleading;
- provide information about the insurance undertaking or intermediary and its services (in particular whether any advice is provided on an independent basis), about the scope of any market analysis (whether on-going suitability assessment will be provided), about proposed products and investment strategies, and about costs. It also specifies the basis on which advice may be said to be independent, which includes a requirement as to the assessment of products on the market and a requirement not to accept remuneration from third parties.

The Commission is empowered to adopt delegated acts to ensure compliance with this article.

Article 25 sets out how suitability and appropriateness is to be assessed, and requires information to be obtained from the customer.

- For non-advised sales, the intermediary or undertaking must obtain information about a customer's knowledge and experience to determine the appropriateness of the product for him.
- For advised sales, it must obtain the customer's financial situation and investment objective to determine suitability.
- Where a product is not appropriate or suitable, as the case may be, the intermediary or insurance undertaking must warn the customer of this.

The Commission is empowered to adopt delegated acts to ensure compliance.

Chapter VIII – Sanctions

Article 26 requires Member States to ensure that effective, proportionate and dissuasive administrative sanctions and measures are taken by competent authorities for breach of the national provisions adopted pursuant to the Directive.

Administrative sanctions and measures must apply to those natural or legal persons which, under national law, are responsible for a breach.

Competent authorities must if given all necessary investigatory powers, and must co-operate on cross-border cases.

Articles 27 to 29 address the sanctions or measures imposed for specified breaches including withdrawal of registration, bans against persons responsible for the exercise of management functions, and pecuniary sanctions, their publication and the factors to take into account in imposing sanctions and measures. EIOPA is required to issue guidelines in respect of the sanctions.

Article 30 requires effective mechanisms to encourage reporting of breaches and an appropriate protection for whistle-blowers and their personal data, as well as the protection of data of natural persons allegedly responsible for breaches.

[23] See paragraph s 0 et seq. of this article.

Article 31 requires annual reporting of aggregate information regarding breaches to EIOPA as well as publication of that information by EIOPA. The Commission is empowered to adopt implementing technical standards in this respect, which EIOPA is to develop and submit to the Commission [6] months after the publication of the Directive.

Chapter IX – Final provisions

Articles 33 and 34 set out conditions applying to the Commission's power to adopt delegated acts as specified in the Directive, and Article 35 provides a process for review and evaluation by the Commission of the Directive after its entry into force, in particular to consider the impact of the disclosure rules in Article 17(2) on non-life insurance intermediaries that are small and medium-sized undertakings.

It remains to be seen whether the final product of the European Parliament and the Council will contain any significant changes to the text reviewed in this article.